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LOAN PUSHING: DOCTRINE AND THEORY

by

William Darity, Jr.

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ABSTRACT This paper examines in depth the hypothesis that the commercial banks "pushed loans" on the less developed countries as the precipitant of the current international debt crisis.

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Long-term lending to non-OPEC LDCs began to grow rapidly, albeit from a small base, in the late 1960s. This growth accelerated in the 1971-73 period, as banks began aggressively to seek new lending outlets by offering narrow spreads on syndicated credits and attractive terms on other types of loans . . . [T]he volume of lending mushroomed after the quadrupling of oil prices in 1973-74.

Laurie Goodman. "Bank Lending to Non-OPEC LDCs: Are Risks Diversifiable?" FRBNY Quarterly Review. Summer 1981, p. 15.

The present signs suggest that the bankers of the world are bent on suicide.

John Maynard Keynes. "The Consequences to the Banks of the Collapse of Money Values (Aug. 1931)" in Essays in Persuasion. New York: W. W. Norton & Company, 1963, p. 178.

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Loan Pushing: Doctrine and Theory
William Darity, Jr.

INTRODUCTION: THE LOAN PUSH DOCTRINE

Debt woes on a global scale compel attention simultaneously to a host of ongoing unresolved theoretical problems for economists. The problems broadly include the appropriate theory of the firm, the appropriate theory of banking behavior, the proper analysis of the formation of contracts, the correct treatment of the formation of individual and market expectations, and the nature of trade cycles and financial crises. Along the fragile precipice of international credit arrangements these problems surface flush red with high drama--a world of big banks, smaller banks, multinational guardian institutions, allegations of neoimperialist conspiracies, borrowing governments of questionable competence and incorruptibility, and persistent poverty among the masses of the populations of many of the borrowing nations.

In pursuit of various aspects of all these problems, this paper focuses in depth on a particular controversy that has arisen in the midst of the international debt crisis--the controversy over the extent to which multinational banks are responsible for the current situation. The claim that the commercial banks "pushed"--in some sense--loans on the less developed countries constitutes the indictment. Proponents of the loan push notion suggest that the banks have engaged in self-victimization by making absurd lending decisions by advancing credit to foreign borrowers who have less than a prayer of making repayment.

This view of bank lending lies at an opposite pole from the view articulated by Irving Friedman. Friedman depicts banks as waiting for applications for loans from around the world and evaluating each loan individually on its merits regardless of its country of origin.[1] Thus, a priori,

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applications from a private business in Brazil and in Chad would be on an equal footing--or the application from the Chadian enterprise will not be dispensed with simply because the business is in Chad. The banks are passive actors in the game. The borrowers must take the initiative. The Chadian firm only would stand no chance of consideration if it failed to submit a loan application.

The doctrine of loan pushing is the antithesis of Friedman's picture. Bankers as loan pushers become active door-to-door salesmen, albeit in pinstripe suits. They persuade borrowers to agree to credits although the borrowers had no thoughts of borrowing at all or, at least, not such large amounts. Moreover from this perspective in euphoric times banks will sell loans to borrowers in regions they customarily leave alone.

The idea that banks force loans on borrowers emerges in the literature exploring financial flows in the 1920s from lenders in the United States to borrowers in Germany and Latin America. Max Winkler's provocative exposé on the underwriting practices of U.S. banks with respect to foreign bonds provided some remarkable anecdotes illustrative of loan pushing. Wirkler described a Bavarian hamlet that was reported to be seeking $125,000 to improve the town's power station. He reported further:

> How could a loan of so small an amount be offered to the American investor who had by now learned to 'invest' by the tens and hundreds of millions? After much persuasion, the mayor of the town in question was convinced of the desirability of contracting a larger loan. The result was a $3,000,000 issue, successfully sold in the American market.[2]

Winkler adds that after the necessary additions were made to the power plant, the balance was used "towards . . . various projects . . . ordinarily termed non-productive."[3]

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In a more general vein Winkler observed that "[d]uring a period of prosperity there is a tendency to extend loans for non-productive purposes or upon dubious security . . . ."[4] But Winkler warned that even if the loans were made "for so-called productive purposes," during "good times" there is still an impulse toward overlending.[5] Plus, Winkler made explicit his opinion that loan pushing took place when he observed ". . . at times even pressure has been brought to bear to induce foreign governments and municipalities to contract loans which they did not want or need."[6] This was the outcome of voracious competition among the underwriters to be first in line to handle bond issues.[7]

Cleona Lewis also provided several examples from the 1920s that are compatible with images of forced borrowing in the following passage:

> Whereas in the middle decades of the nineteenth century American promoters had scoured Europe in search of foreign lenders, in 1925-29 they were searching the world over for foreign borrowers. At one time, according to testimony before the Senate Committee on Finance investigating the sale of foreign securities in the United States, there were 29 representatives of American financial houses in Colombia alone trying to negotiate loans for the national government, for the departments, and for other possible borrowers. Some 36 houses, most of them American, competed for a city of Budapest loan and 14 for a loan to the city of Belgrade . . . In Peru, a group of successful American promoters included one Peruvian, the son of the President of that republic, who was afterward tried by the courts of his country and convicted of 'illegal enrichment.' In Cuba the son-in-law of the President was given a well-paid position in the Cuban branch of an American bank during most of the time the bank was successfully competing against other American banks for the privilege of financing the Cuban government."[8]

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Lewis's work highlighted another feature of the loan push doctrine--the creation of foreign markets for U.S. producers. Lewis found that numerous overseas loans were arranged for public works projects in the LDC's of the 1920s and that ". . . big American construction companies sometimes helped finance public works in foreign countries, sometimes secured their contracts on a competitive basis after the financing had been arranged."[9] In general, she concluded that infrastructural "loans and contracts provided a considerable market for American materials and services."[10] The stimulus for products of U.S. origin had far-reaching dimensions:

> The roadbuilding contracts, for example, expanded the demand for American steam shovels and grading machinery; and also called for cement and asphalt from the South American and Cuban subsidiaries of American companies. The building of sanitation, gas, and waterworks systems called for metal pipes and plumbing supplies. Railway building called for steel rails, engines and cars. The execution of all these contracts gave employment abroad to a large number of American engineers, and also called for additional numbers of employees in the home offices of the companies concerned.[11]

Henry Wallich perceived that, in the aggregate, the expansionary boost to American production in the 1920s from the Latin loans was sufficiently large to make the loans a net benefit for the U.S. economy, <u>despite</u> the subsequent defaults.[12]

However, from the standpoint of the ultimate lenders of the 1920s, the bondholders, the situation was unpleasant. As Wallich noted, ". . . it is obvious that by far the heaviest part of the burden, if not all of it, rested upon the security holders."[13] The ultimate lenders

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could delay the day of reckoning by extending additional credit to foreign borrowers, but, at that stage, as Max Winkler suggested in his customary purple prose "the lender becomes a slave to the borrower."[14]

At some point when the record of default by foreign borrowers crosses some intolerable threshold the revulsion set in. The ultimate lenders will swallow their losses and retreat en masse from the international capital markets. By the early 1930s it had become virtually impossible for the less developed countries to float a new issue. Lewis dated the revulsion from the credit contraction in the United States associated with the 1929 collapse of share prices on the New York stock exchange.[15] Wallich argued that the worldwide depression of the 1930s was the fundamental event that brought down the house of cards--simultaneously aggravating the borrowers' inability to pay and the lenders' refusal to continue to finance the debt.[16]

In summary, six major features emerge in the literature on the loan adventures of the 1920s that relate to the loan "pushing" phenomenon: (1) There was the promotional-cum-persuasion aspect, where the initiative to borrow comes from the lenders. Borrowers received more than they, themselves, conceived as feasible or necessary at the outset. (2) Concomitantly, there is the implication that there was a surplus of funds that was unable to seep into normal outlets that made its way into the less developed regions. This notion is plainly evident in Cleona Lewis' description of the shift on the part of U.S. promoters from a search for lenders overseas in the mid-1800s to a search for borrowers overseas during the mid-1920s. (3) The foreign lending wave involved nepotistic connections and corruption

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in the arrangement of the loans. (4) The loans performed a market-making function for numerous U.S. producers. The loans created the financial capacity in the less developed countries to purchase the output of U.S. enterprises. (5) When concrete evidence of softness in the ability of the borrowers to meet their obligations became visible, the lenders initially tried to resolve the situation by continuing to lend. (6) Eventually, the lenders withdrew altogether from providing funds (or the period of revulsion took hold).

These six features all appear in the literature that explores the foreign loan crisis of the 1980s. However, it should be kept in mind that unlike the loans of the 1920s, when the commercial banks played an underwriting function thus transferring the risks of lending onto the shoulders of the bondholders, the loans made in the 1970s have been made directly by the banks themselves. This means that the banks and their depositors--which may be other banks depending upon the structure of interbank relations--directly share the risks today. For the time being, the question of why bank loan finance has replaced bond finance in international credit markets is left aside.[17]

The promotional aspect, or the process of creation of borrowers, is reflected in T. H. Donaldson's nervous warning about the pattern of lending toward the end of the previous decade:

> There is a developing feeling . . . that some banks are so concerned with finding borrowers--any borrowers--that they are occasionaly overpersuading countries who should more sensibly be cautioned against too much borrowing. If this fear proves justified, the banks concerned are storing up trouble not only for themselves and the borrowers involved, but for many other banks and borrowers who will suffer from the repercussions of future problems[18]

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Charles Kindleberger's rhetoric conveys an even more dramatic picture:

> . . . contemplate the enormous external debt of the developing countries, built up not only since the rise of oil prices but importantly--a widely ignored fact--in the several years before that time, as multinational banks swollen with dollars tumbled over one another in trying to uncover new foreign borrowers and practically forced money on the less-developed countries.[19]

The image of the multinational banks gorged with dollars is consistent with the second feature of the loan push doctrine--the existence of surplus funds that eventually gravitate toward unorthodox recipients. Excess dollars in the late 1960s and early 1970s have been attributed to the explosive development of the unregulated Euro-currency market. Softening demand for commercial bank funds by the banks' preferred clients beginning in 1971, coupled with the growth in the funds the banks wished to make available to borrowers, led, in this view, to the cultivation of borrowers from regions customarily ignored.[20] The recycling of OPEC surpluses in the aftermath of the first major oil price increase is seen as aggravating the surplus funds condition but not fundamental to the beginnings of the situation.[21] The Euromarket is the structure perceived as lying at the heart of these developments. The growth of the Euro-currency market since the start of the 1970s has been accompanied by a shift in the asset base of the participating banks away from corporate lending toward sovereign lending.[22]

Specifics on nepotistic-corruption elements in contemporary loan making are harder to detail than the facts that surfaced in the 1920s. But former banker S. C. Gwynne's confessional exposé on his own involvement in

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arranging a $10 million loan from an anonymous "medium-sized Midwestern bank with $5 billion in assets" to a Philippine construction company throws out a host of hints in this direction as the author describes his maneuvers in 1978 in southeast Asia.[23]

Gwynne's article does provide explicit evidence of the loan performing a market making function. A major depositor with Gwynne's bank--an "earth-moving equipment company, a subsidiary of a major auto company and an old client of the bank"--emerges as the principal force pressuring for the loan.[24] The earth-moving company anticipated, correctly, that the loan would finance shipments of its product to the Philippine construction company. As Gwynne reports, once the loan had been approved formally, "Three weeks later, we disburse $5 million, the first in a series of 'drawdowns' that will correspond to shipments of earth-moving equipment. Although our transfer bank, Chase Manhattan, manages to lose the $5 million for a few frantic days, the money eventually lands in the right account."[25]

It would be interesting to learn how many instances of commercial bank loans involve financing demand for products made by their major customers. The impression given by Lewis and Wallich on bond finance in the 1920s was that of a broad external stimulus to U.S. aggregate demand. A similar impression appears in connection with the Wall Street Journal's description of the effects of the recent wave of U.S. bank loans to Mexico; in fact, the following passage contains the entire mix of curruption, market-making, and loans soon to

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go bad:

> In the late 1970s salad days when the oil looked inexhaustible, the [Mexican] government's development plans focused on massive capital projects that were heavily dependent on imported materials; steel mills, oil installations and electrical power plants were prominent. Imports soon began rising at a faster rate than exports, and the deficit in trade and services grew.
>
> Much of the investment went to notoriously inefficient state-owned agencies and companies. That led to wasted money. Corruption drained further resources. Allegations of corruption at Pemex alone run into billions of dollars. The architect of its expansion, Jorge Diaz Serrano, is in jail awaiting trial on charges of fraud.[26]

As for the fifth and sixth features of the loan push story that are apparent in the stories of the 1920s--initially continued lending to support unstable borrowers and then revulsion on the part of the borrowers--the former response has been more in evidence with respect to major borrowing nations. The situation in the 1980s is more difficult to interpret than that of a half-century earlier because of the existence of both multinational institutions and national institutions in the developed countries that play an active role in international financial markets. These include the IMF, the World Bank, and the central banks in the West, especially the U.S. Federal Reserve Board. Would the revulsion have taken hold on a wide scale already if these institutions had not prompted further syndications to continue to provide credit to these nations during their current period of difficulty? On the other hand, would the banks be able to maintain as hard a line on the terms for reschedulings and new credits if not for the existence of the IMF and its austerity program for troubled debtor nations?[27] Suffice it to say that the world is not yet at a stage where creditors have withdrawn en masse from the international credit markets.

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In summary, there are two contrasting views of banking practice. The first view is advanced by Irving Friedman which treats the banks as the passive actors. The second view appears in the quasi-anecdotal histories of the bond finance episode of the 1920s. Here the bankers are viewed as the active agents, literally covering the globe to find new borrowers. This second view finds echoes in some of the literature that attempts to assess the current international debt crisis.

It is the latter view--inclusive of the six features identified above as components of a broader loan push doctrine--that is the object of inquiry of this paper. In the section that follows an attempt will be made to give rigorous meaning to the idea of loan pushing. After that, the concept of loan pushing will be considered in the context of competing explanations of the current international debt crisis. A final section will provide an overview of the issues raised in the paper and present some conclusions.

THE CONCEPT OF "PUSHING" LOANS

The loan "push" doctrine was depicted in the previous section as a complex of attributes. But the specific act of "pushing" or "forcing" loans requires elaboration. Obviously, it does not mean that bankers force officials in LDCs to accept loan contracts at gunpoint. The act of pushing a loan must involve the structure of incentives offered to potential borrowers--incentives that are out of step with the risk characteristics possessed by the borrowers.

For Brimmer, pushing loans involves a drastic softening of terms relative to the expectations of the potential borrowers. When the Euro-currency banks turned their attention toward the developing countries,

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Brimmer argued that they reduced the spread between their cost of funds (LIBOR) and the loan rate they offered LDC borrowers. In addition, in general, they lengthened the maturities on the loans and substantially raised the amounts they were willing to lend.[28] From Brimmer's perspective, the commercial banks, in an effort to dispose of their surplus funds in the periphery, made their terms particularly attractive to LDC borrowers.

The pattern of declining spreads and lengthening maturities is especially plain between the final quarter of 1975 and the final quarter of 1979 for both non-OPEC LDCs and OPEC nations at the aggregate level (see Table 1). It is also plain for the major debtor nations (see Table 2). Signs of reversal become visible in 1980 and 1981 as repayment difficulties accelerate and as reschedulings were negotiated on harsher terms than the initial loans.

The key point in the Brimmer conceptualization of loan pushing is the implied segmentation of the global financial market between borrowers in the developed and developing worlds. The commercial banks only turn in a comprehensive fashion toward the LDCs when loan demand from sources in the developed world weakens sufficiently for the terms required to bring forth additional demand to be perceived as unprofitable. To make the new loans in the countries of the periphery may have necessitated comparatively soft terms for borrowers there, but those terms still were perceived as adequate to produce a desired degree of profitability by the lenders.

Kindleberger, while acknowledging that his observation quoted above about banks "'forcing' loans on the LDCs is a bit hyperbolic," also has attempted to give precision to loan "pushing." He argues that sharp differences exist in opportunities to contract for interest rates across

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TABLE 1

INTEREST RATE SPREADS (OVER LIBOR) AND MATURITIES ON EURO-CURRENCY CREDITS TO NON-OPEC LDCs, OPEC NATIONS, AND ALL NATIONS, 1975-1981

NON-OPEC LDCs	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
WEIGHTED MEAN SPREADS	1.65	1.87	1.77	1.06	.76	1.10	1.16
UNWEIGHTED MEAN SPREADS	1.82	1.90	1.76	1.04	.90	.93	.95
WEIGHTED MEAN MATURITIES	5.44	5.14	7.32	9.79	10.11	8.06	7.31
OPEC	**1975Q4**	**1976Q4**	**1977Q4**	**1978Q4**	**1979Q4**	**1980Q4**	**1981Q4**
WEIGHTED MEAN SPREADS	1.67	1.34	1.59	1.11	.75	.81	.69
UNWEIGHTED MEAN SPREADS	1.65	1.56	1.52	1.14	.82	1.16	.79
WEIGHTED MEAN MATURITIES	5.66	6.95	5.48	8.59	8.42	4.80	9.60
TOTAL SAMPLE	**1975Q4**	**1976Q4**	**1977Q4**	**1978Q4**	**1979Q4**	**1980Q4**	**1981Q4**
WEIGHTED MEAN SPREADS	1.63	1.58	1.48	.83	.68	.83	.88
UNWEIGHTED MEAN SPREADS	1.67	1.56	1.41	.88	.77	.81	.75
WEIGHTED MEAN MATURITIES	5.63	5.61	6.79	8.88	9.64	7.79	8.11

Interest rate spreads are calculated as percent per annum.

Maturities are calculated as numbers of years.

Weights were based on the volume of credits for each country in the current quarter.

Source: Memorandum prepared by Rodney H. Mills Jr. entitled "Spreads and Maturities on Eurocurrency Credits--Fourth Quarter 1981 and Two-Year Review," Board of Governors of the Federal Reserve System, March 3, 1982.

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TABLE 2

INTEREST RATE SPREADS (OVER LIBOR) AND MATURITIES
ON EUROCURRENCY CREDITS TO SELECTED MAJOR DEBTOR NATIONS, 1975-1981

ARGENTINA	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	--	1.88	1.58	.88	.76	.63	1.09
MATURITY	--	4.00	9.14	11.05	10.43	7.65	7.33
BRAZIL	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	1.72	1.95	2.20	1.26	.72	1.79	2.14
MATURITY	6.80	5.71	7.76	11.52	12.03	8.87	8.00
CHILE	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	--	--	1.93	1.10	.92	.93	1.01
MATURITY	--	--	4.33	9.57	9.80	7.30	5.06
MEXICO	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	2.00	2.05	1.88	.91	.69	.90	.60
MATURITY	4.76	5.97	7.00	7.93	8.34	6.96	5.41
KOREA	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	1.47	1.63	1.75	.95	.69	.52	.63
MATURITY	3.50	5.32	7.00	9.34	9.61	7.52	7.46
POLAND	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	1.50	1.50	--	--	.83	1.13	--
MATURITY	6.00	7.00	--	--	3.00	3.00	--
VENEZUELA	1975Q4	1976Q4	1977Q4	1978Q4	1979Q4	1980Q4	1981Q4
SPREAD	--	1.63	1.63	1.35	--	.68	--
MATURITY	--	5.90	6.00	5.70	--	5.00	--

Interest rate spreads are calculated as percent per annum.

Maturities are calculated as numbers of years.

Source: Memorandum prepared by Rodney H. Mills, Jr. entitled "Spreads and Maturities on Eurocurrency Credits--Fourth Quarter 1981 and Two-Year Review" Board of Governors of the Federal Reserve System, March 3, 1982.

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borrowers with varying risk characteristics.[29] Kindleberger constructs a position that resembles the implications of the ancient mercantilist doctrine of the utility of poverty for the labor supply function; instead, Kindleberger is concerned with the shape of the supply curve for loanable funds. Kindleberger writes:

> . . . when interest rates decline sharply for any reason, lenders look around to make loans at high interest rates and take greater risks, in a sort of backward-bending supply curve, to preserve their old incomes.[30]

According to Kindleberger the recent build-up of LDC indebtedness was triggered by former Federal Reserve chairman Arthur Burns' "cheap money efforts . . . in the early part of 1971"; this depressed interest rates in the Euro-dollar market and led the participating banks to chase down potential borrowers in the LDCs, particularly in Latin America.

Thus, the commercial banks are portrayed as attempting to avert reductions in their profitability or earnings by shifting toward LDC borrowers.[31] The banks were unwilling to accept a decline in terms great enough to achieve full absorption of their loanable funds at the center. On the other hand, softening the terms for periphery borrowers to a sufficient degree to stimulate their consent to contract for large sums of indebtedness would still leave the banks with what they considered to be adequate margins for profitability.

"Pushing," then, amounts to design of loan packages that attract borrowers who formerly were denied access to international credit markets altogether or who were, at least, denied such large amounts of funds. The LDC borrowers' risk characteristics, which presumably were responsible for their previous exclusion from easy credit terms, remain unchanged. But suddenly instead of being parians for the major international lending

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institutions they find creditors clamoring for their attention. The wallflowers become the belles of the dollar ball.

THEORIES OF THE DEBT CRISIS AND "PUSHING" LOANS

Both the concept and the doctrine of loan "pushing" fit with varying degrees of ease within the folds of various theories of the current international debt crisis. Theories to be given critical consideration here are those that rely upon (1) the rational expectations hypothesis, (2) uninformed bankers, (3) a principal-agent dilemma, (4) an over-borrowing thesis, (5) the Minsky financial instability hypothesis, (6) the moral hazard problem, and (7) the evolutionary tendency toward concentration under the regime of finance capital.

A. The Rational Expectations Hypothesis

Explanations of the massive build-up of indebtedness in less developed countries compatible with the belief that bankers possess rational expectations (or stochastic perfect foresight) either treat the growth in periphery debt as no object for alarm or due to unforeseeable shocks. The first view, in effect, says that the debt crisis is not really a crisis after all. The second view says that the bankers were surprised and that the surprises could not have been prevented since they were purely random events.

Michael Beenstock is perhaps the premier exponent of the first view.[32] Beenstock's "transition theory" says that the LDCs are now becoming the major global industrial centers. Deindustrialization in the center and industrialization in the periphery--particularly in the so-called newly-industrializing countries (NICs)--has meant (autonomous?) shifts in the

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marginal product of capital schedules in each region. The downward shift in the center nations and the upward shift in the periphery nations raised the rate of return on capital in the developing countries relative to the developed countries. Short-term effects from the oil price hikes have contributed to the increased indebtedness of the non-OPEC LDCs, but the structural change in the world economy that has shifted industrial growth toward some of those nations becomes the fundamental cause of the increase in debt.

Beenstock points to the fact that growth in LDC manufactures has accompanied growth in their debt as an indication of the correctness of his explanation. He suggests that the situation is analogous, for example, to the indebtedness incurred by borrowers in the United States during its 19th century phase of industrialization. The growth in LDC debt today is merely an equilibrium adjustment reflecting the necessary flows in finance from low return regions to high return regions. There is no reason for panic, according to Beenstock. The NICs will become industrial centers within twenty to thirty years and the current disarray is only a temporary period of pain that goes hand in hand with the international structural rearrangements.

Beenstock also offers evidence on LDC debt-service ratios to reinforce his claim that there is nothing extraordinary about the present episode. He utilizes a graph that reveals that interest and payments on principal divided by exports for LDCs was not unusually high by historical standards over the interval 1970-79; by 1979 the ratio had reached only 12%.[33]

The bankers' loans, then, were perfectly reasonable. If they did set terms that would lure LDC borrowers into their clutches those terms reflected

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a reasonable calculation of prospects for efficacious use of their loans and subsequent repayment. After all the greatest volume of loans were going to those LDCs that displayed the best prospects for industrial development. The biggest borrowers were members of what Lawrence Franko has called the "charmed circle of ten."[34] (Also see Table 3 for the ten LDCs with the largest foreign debt.) Oil price shocks and export commodity price declines were all events that make for debt service problems for some of these borrowers, but these are transitory difficulties. The underlying trend is toward solvency. The bankers' loans were made wisely, i.e., rationally, and there is no enduring international debt crisis.

In addition, it is often pointed out, the loss rate on foreign loans actually is lower for U.S. banks than the loss rate on domestic loans. For example, in February 1983 testimony before the House Committee on Banking, Finance and Urban Affairs the Fed chairman, Paul Volcker, reported that ". . . losses on foreign credits of commercial banks continued to be substantially lower than on domestic lending . . . ."[35] This piece of data routinely is used to reinforce the impression that the bankers' eagerness to loan to the LDCs during the 1970s was sensible.

Furthermore, it is argued the bankers can rely upon some natural safeguards inherent in their approach to lending. Specifically, Laurie Goodman has placed emphasis on the bankers' capacity to diversify their lending to reduce the degree of covariance between the various credits they issue. Goodman, writing shortly before the Mexican peso drama in 1981, was so optimistic about the effectiveness of diversification that she could conclude "that the nightmares of bankers, regulators, and journalists of massive LDC defaults paralyzing the United States banking system are not warranted on economic grounds."[36]

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TABLE 3

DEBT IN BILLIONS OF DOLLARS
(Estimates in September 1983)

NATION	DEBT
Brazil	$92
Mexico	$87
Argentina	$37
Venezuela	$35
Poland	$27
Yugoslavia	$19
Chile	$18
Nigeria	$14
Peru	$12
Romania	$10

SOURCE: "The International Debt Crisis: The Major Third World Trouble Spots," The Washington Post, September 25, 1983, p. H1.

Beenstock's secular explanation for the build-up of LDC debt is intriguing, but it poses its own set of puzzles. Is it believable that differentials in the interest rates that could be contracted on loans in the center and the periphery were grounded in differences in the real return on capital? Even if Brazil is destined to be where the U.S.A. is today by the year 2010, does it mean that the typical loan received will be utilized to generate earnings sufficient to pay the lender the prospective real return?

Kindleberger, for one, has a far less felicitous view of the uses of funds by LDC borrowers, contending that the historical record reveals that

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". . . productive loans in the developing countries are not very productive and do not stay long out of default . . . ."[37] Indeed, one wonders why the grounds for optimism about the relative potential for economic development in Argentina in the 1970s ought to be any greater than it was in the 1920s. "Development" loans do not have an impressive history of success. They rarely have produced anything that resembles economic development, and they often have produced defaults.[38] If the past provides a guide to the future, commercial bankers in the 1970s should have forecast rationally that their foreign loans to the periphery were going to go bad.

Regardless, calculation of the real returns on loans, inclusive of an accounting for risks of repayment difficulties, is a dubious proposition. A climate of non-calculable risk envelops lending decisions. Uncertainty takes on a subjectivist cast in the sense that it precludes formulation of mathematical or even ordinally systematic expectations. In his discussion of country risk analysis, Wallich says, "Practitioners of this activity are the first to point out that analysis of country risk is not a science. I hesitate to call it an art; perhaps it may be dignified by the term 'craft.'"[39] Wallich adds that a host of variables typically are examined to gauge debt service capability--export volume, GNP, level of foreign reserves, available credit facilities, and "compressibility of imports"--but warns:

> . . . these are very partial relationships. In some of them the variables are not even accurately defined. Far more subtle and detailed relationships and data can and need to be brought to bear on the problem. Even then different views can be supported by the same basic facts.[40]

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Especially difficult outcomes to forecast are the effects of the actions of one debtor on others. If one defaults, will others follow suit?[41] The game-theoretic literature suggests that it is a devastatingly open-ended question that only can be given an unequivocal answer if stringent--and unrealistic--assumptions are employed.[42]

Stephen Dubrul Jr.'s observation that ". . . the only certainty in international finance is uncertainty . . ."[43] is especially telling. There is no magic formula that permits the bankers to calculate the real return on their loans. They are confronted with uncertainty in Keynes' most disturbing sense.[44] The bankers cannot tell what real return will be earned on capital in the future. They cannot see the future. Their decisions must be made despite inherently frail prognostications.

It also is interesting to note that a more careful look at the variable that Beenstock isolates to support his position--the debt-service ratio--actually is susceptible to mounting the opposite case. Beenstock probably is a victim of the date of publication of his manuscript. His data on debt-service ratios runs up through 1979, but by 1981 the debt-service ratio had reached 20% for LDCs in general and was climbing. Those ratios were in the vicinity of Latin American debt-service ratios between 1930 and 1937.[45]

A recent study by Dooley et al. reinforces how dramatically the debt-service ratios for LDC borrowers have changed since the publication of Beenstock's book. While admitting that they "do not know what level of this ratio is sustainable for any country nor . . . that it is the only relevant measure of country's debt position," Dooley and his co-authors contend that ratio of real net interest payments to exports "clearly show

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a deterioration in the external position of several of these countries to levels that are very high by historical standards."[46] Note that the Dooley et al. measure of debt-service capability is more conservative than Beenstock's because their measure does not include payments on principal that would permit amortization of the debt. If anything, the Dooley et al. measure understates the problems LDC's face in meeting their debt obligations.

By their measure of real net interest as a percentage of exports the situation is especially drastic for Mexico, Brazil, and Argentina. The Dooley et al. debt service ratio was 16% for Mexico and 24% for Brazil and Argentina by 1982.[47]

Dooley and his coauthors suggest that the debt-service ratios were quite different before 1981 and 1982 because (1) "the dollar value of these countries' exports grew rapidly throughout the 1970s in both volume and value terms," (2) "dollar prices of oil and other exports grew faster than the dollar prices of traded goods in general," and (3) growth of the debt burden was contained "by generally low or at times negative real interest rates on dollar [denominated] debt."[48] In 1981 and 1982 conditions changed. The rate of export growth tailed off due to the impact of worldwide recession. Plus ". . . interest rates on floating rate dollar debt rose relative to inflation rates so that real interest costs on existing debt increased substantially."[49]

It is true that losses on bank loans to LDC borrowers remain low relative to losses on loans to domestic borrowers for U.S. banks in particular. This fact may provide comfort to those who share the Beenstockian

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view that the crisis is not a crisis after all. But the figures on loan losses on foreign debts are deceptive. The large money-center banks are able to avoid listing their nonperforming loans as "nonperforming" in their regulatory reports. They can roll the loans over through automatic or near-automatic refinancing or rescheduling arrangements to avoid having to deduct them from their assets.[50] Makin provides details on how the major U.S. money-center bankers "handled" their nonperforming loans to Brazil in 1983:

> Citicorp was not alone in facing heavy write-downs on Brazilian loans, where arrearages had mounted by the fall of 1983 to over $4 billion. Among Citicorp's fellow New York banks, Manufacturers Hanover had $2.0 billion in Brazilian loans, and development-loan-oriented Chase, $2.6 billion--both exposures comparable to Citibank's in view of their smaller net worth. It is likely that some judicious rolling over of loans had been required to avoid triggering the "nonperforming" alarm bell on Brazilian loans. We have already seen that loans that had a sixty-day nonpermanence clause had in September 1983 been relaxed to a ninety-day clause to avoid the costly nonperformance designation. With respect to their LDC clients, the mighty banks were in the position of a bomb squad disarming a time bomb. Top priority at the moment was to disarm the nonperforming fuse--or worse yet, the default fuse--before it ignited the debt bomb. At such a critical moment capturing the bomber--like reflection on fundamental causes of, and long-run solutions to, the massive overhang of developing country debt--was a secondary consideration.[51]

Companies in Mexico did not pay any interest on their debts between August 1982 and January 1983 because they could not get access to U.S. dollars. The government inaugurated exchange controls on August 5, 1982, dictating that only the government could buy and sell dollars at a preferential rate of 50 pesos per dollar. But the government of Mexico had no

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dollars to sell, regardless of the exchange rate. The commercial banks threatened to hold off new loans to the Mexican government until they received interest from private sector borrowers. But the banks' threat was a consequence of their fear that they would have to label many of their private sector loans to Mexican borrowers as nonperforming. By February 1983 the commercial banks had put together the largest syndication in financial history--a syndicate of 500 commercial lenders--to provide $4.8 billion in loans for 1983 to permit the financing of the prior interest obligations.[52] This was roll over in its highest form. The quid pro quo commercial banks demanded by the commercial banks was harsher terms on refinancing the Mexican government's own debt. The government, according to the banks, did not want to contract for more than one point above LIBOR (which was at 15% in early 1983), but the banks insisted upon 1½% above LIBOR.[53]

Bankers are loath to report any of their loans as nonperforming, which would require them to record them on a nonaccrual basis. It is easier for them to avoid such reports on foreign loans due to the nature of the existing regulatory arrangements.[54] The banks have interpreted the prevailing regulations as meaning that they can record interest on loans although the interest remains unpaid. The banks assert that this is legitimate under existing rules as long as they "believe the loans are well-secured and in the process of collection."[55] Of course, the banks are largely free to determine whether or not a particular loan is "well-secured and in the process of collection." Only very recently is there any evidence that the comptroller of the currency and the Federal Reserve Board have

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begun to attempt to "clarify" the accounting rules to tighten the conditions under which banks can continue to report interest on loans that is 90 days overdue as if it has been received.[56]

What may be a more difficult management problem for the money-center banks than avoiding writing down their earnings on Latin debt is preventing their stocks from being ravaged on the securities market. Investors may simply look through the accounting gambits and make a negative judgment about the earnings position of the banks due to doubts about their LDC loans.[57] The question remains whether or not investor reaction is a sufficient disciplining force to rein in excessive lending by the commercial banks. The issue will be treated in greater depth below when the principal-agent dilemma approach to the international debt crisis is examined. To the extent that the current crisis is an authentic index of fundamental weakness in the international financial system, the investor response only appears to have an ex post impact--after the loans already have been made that eventually become nonperforming.

The bankers' natural safeguards--such as diversification which is given such an enthusiastic endorsement by Goodman--certainly has not proven effective during this episode of lending to the LDCs. The banks made a special effort to lend to non oil exporting LDCs and oil-exporting LDCs simultaneously, ostensibly to cover themselves regardless of what happened to petroleum prices. Additional increases in oil prices would hurt the balance of payments position of the non-oil exporting LDCs, but enhance the ability of the oil exporters to repay their loans. Decreases in oil prices would have the opposite effect.

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But in an environment of softening petroleum prices during the start of the 1980s both sets of countries began to experience serious balance of payments difficulties. The falling petroleum prices would have an obvious adverse effect on the oil-exporters with large external debt, e.g., Mexico and Venezuela. The oil importers, e.g., Brazil and Argentina, should have benefitted but several factors combined to undermine the presumptions of portfolio diversification. The combination of rising real interest rates, the drop in commodity prices for their (non-oil) exports, and the generalized global downturn of 1980-82 pushed them into the hole of illiquidity as well. Plus while the oil-exporters had benefitted from the oil price rise of 1978 and 1979, the oil-importers already had been placed in a difficult situation by the last oil price boom.[58] Retrospectively, important aspects of the "risks" of foreign lending were "non-diversifiable." The correlation between the poor growth experiences of the LDCs in the banks' foreign loan portfolios proved to be quite strong rather than weak in the early 1980s.[59]

All this suggests that if one is to maintain an explanation of the debt crisis compatible with the assumption that the bankers acted based upon expectations formed rationally there are three options. First one can continue to hold that the present problems are transitory and will reverse themselves in the normal course of events without a major intervention by national or multinational monetary authorities. One might continue to hold such a position despite the historical precedents on LDC lending,

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the statistical evidence cited above on debt service ratios for major LDC debtor nations, the substantial record of nonperformance on these loans, and the obvious failure of the bankers' natural safeguard of diversification to ensure that their portfolios are comprised of a reasonably balanced mix of developing nations with positive as well as negative rates of overall economic growth or net export growth. Second, one can hold that the bankers made the loans fully expecting the overwhelming majority of them to go bad. To pursue this intriguing possibility it seems only reasonable to establish that there is some overall advantage to banks from making bad loans. Finally, one can argue that the bankers made their decisions based upon expectations formed rationally, but they were surprised by an unforeseen and unforeseeable event that made the loans perform badly.

The position that the debt crisis is the outcome of a random shock is most fully developed by Sachs and Bruno.[60] They place special emphasis on the oil price shock and its effects as the key random event that sent the borrowing nations into arrears on their debt payments. They have not selected the most satisfactory surprise, however, (1) since it would be difficult to support the view that the second oil price boost of 1978 and 1979 was a "shock" and (2) since loan portfolio diversification was intended to cope with just such an eventuality.

A superior candidate may be the Fed's maintenance of a stringent disinflationary policy. A case can be made that no one--including the bankers--expected the Federal Reserve to stick by its tight money guns so intently. The economists attached to the Fisherian theory of interest

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rates were baffled as the real rate of interest on the dollar went from low and even negative rates to historically unprecedented levels over the course of the past several years. John Makin, for one, places the onus of the international debt crisis at the doorstep of the Fed's great success in bringing down the U.S. inflation rate; he depicts Walter Wriston as one money-center banker who was "shocked" by the Fed's vigilance:

> What remains is to determine what force on earth could bring to so sudden a stop the music that both borrowers and lenders had been so pleased to hear and dance to with such abandon from 1974 to 1981. In two words, it was Paul Volcker. Again Wriston is the spokesman who characterizes a transition from the banker's perspective. Asked in a 1978 interview whether he would welcome any restrictions on any U.S. lenders or borrowers, Wriston replied: "I just want the opposite. Let us have their freedoms." "Which ones?" asked the interviewer. Wriston replied: "I believe the most important thing the bank will have to deal with over the next 10 years is not money policy, because the options are limited and there isn't much elbow room. [Rather] it's the revolution in the financial business of America."
>
> Five years later, asked the inevitable "what's gone wrong now" question in another interview just before the September annual meetings of the IMF and World Bank, Wriston replied: "We're beat upon the fact that we have imprudent moments. But I don't know anyone that knew Volcker was going to lock the wheels of the world."[61]

From this perspective the banks and their borrowers got caught in the left-hand tail of the rate of return frequency distribution due to the random shock created by a surprising commitment to disinflation by the U.S. central bank. The bankers' lending terms were reasonable, conditional on their reasonable forecasts of the world economy's direction. Floating rates on loan contracts tied to reference nominal rates designed to protect the lenders from high inflation punished the carriers of dollar-denominated debt as inflation was wrung out of the U.S. economy.

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Short of the cynical, but potentially defensible, position that the bankers intentionally made bad loans, the rational expectations hypothesis suggests either that there is no debt crisis or, if there is one, it is due to a stochastic shock. In either case, if loan "pushing" occured, it was not overlending given the well-reasoned judgments of the lenders. If the terms were softened to encourage LDC borrowers those terms were consistent with best estimates of the risks involved--country risk, credit risk, exchange risk, etc.--at the time the loan contracts were made initially.

B. Uninformed Bankers

At the opposite pole from rational expectations based explanations for the debt crisis is the explanation that attributes the situation to poor judgment by the bankers. Unlike the rational expectations view that the bankers were as well-informed as possible in making their loans, this perspective holds that the bankers operated without adequate knowledge relative to the available information. Bad loans were made because of carelessness and insufficient investigation of the circumstances of the borrowers; poor knowledge led to the current debt crisis.

The explanation can be given a generational cast. The current wave of bank managers either have forgotten or never were familiar with the troubled history of LDC loans. The fifty year waves of LDC loans occur precisely because it takes about that amount of time for the older group of captains of finance to be entirely replaced with a younger group that is unaware of the lessons to be learned from the past.

S. C. Gwynne's revelations on the foreign loan business as an employee of a medium-sized Ohio bank provide some support for this explanation. He describes his own rise into the trenches as a twenty-five year old front-

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line loan officer in the Philippines in 1978 after ". . . one and a half years of banking experience [after joining] the bank as a 'credit analyst' on the strength of an MA in English [and after promotion] eleven months later to loan officer and [assignment] to the French speaking Arab nations [because of my fluency in French]."[62] Gwynne adds further that he was not unique:

> I am far from alone in my youth and inexperience. The world of international banking is now full of aggressive, bright, but hopelessly inexperienced lenders in their mid-twenties. They travel the world like itinerant brushmen, filling loan quotas, peddling financial wares, and living high on the hog. Their bosses are often bright but hopelessly inexperienced twenty-nine-year-old vice presidents with wardrobes from Brooks Brothers, MBAs from Wharton or Stanford, and so little credit training they would have trouble with a simple retail installment loan.[63]

As for the bosses above these young vice presidents--the senior loan officers--Gwynne describes them as "pragmatic, nuts-and-bolts bankers whose grasp of local banking is often profound, the product of twenty or thirty years of experience [however, they] are fish out of water when it comes to international lending."[64] According to Gwynne, the senior bankers had no desire to move into the foreign loan market "but were forced into it by the internationalization of American commerce; as their local clientele expanded into foreign trade, they had no choice but to follow them or lose the business to the money-center banks."[65]

On the face of it, Gwynne's story is one of inadequate information at all levels of the decision-making apparatus--at least among the second tier of banks, if not the money-center banks as well. But his story also involves the market making function of the loans on behalf of the banks' domestic corporate depositors. As noted above, the loan Gwynne himself arranged in the

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Philippines was prompted by the insistence of one of his bank's key depositors. Were the senior loan officers who approved the foreign loan that subsequently went bad acting out of ignorance or self-preservation? Presumably, they managed to retain their major depositor although, eventually, they had to write-down the loan. To the extent that the depositor was able to make some sales to the importer in the Philippines, some of the funds lent abroad may have returned to the bank's balance sheet through the depositor's own account.

Typically, negotiations were conducted primarily between LDC governments and the large banks to bring together a wide range of public and private sector borrowers in the developing countries and numerous second line banks in the developed countries. As Makin continues:

> But as we've seen with a large number of separate projects under a government umbrella, the bankers saved themselves the cost of carefully investigating each project to determine its profitability and potential to repay borrowing, assuming they even had the language skills and technical and regional experience required to do so. Rather, the bankers could just deal with the governments guaranteeing these debts, pledging as collateral their ability to tax their citizens. The pledged word of a great republic like Brazil is very imposing at the time it is given, and somehow it induced a retroactive belief that governments do not default their debts.[66]

But of course governments have defaulted in the past, despite the potential danger of being ousted from the international credit markets. When reschedulings and refinancing arrangements are made, it plunges borrower and lender into a murky region where on some interpretations default de facto might have occurred actually. Makin does suggest in the next paragraph of his book that the larger banks had a quite reasonable

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pecuniary motive for setting up the foreign loan syndication. They could receive loan fees for setting up the consortium of lenders, and they would receive this money at the outset. The larger the loan, the greater the winnings attributable to economies of scale of banking:

> Fees for arranging the loans averaged about 1 percent of their value. The difference between the bank's cost of funds and the lending rate are expressed as 'spreads,' percentages of the value of the loan--which, while typically lower for large borrowers, vary a good deal less than the size of the loan. One percent of a $200 million loan is $2 million, while 2 percent of a $100,000 loan is only $2,000. It does not require anywhere near one thousand times the effort expended on a $100,000 loan to arrange a $200 million loan, and even if syndication costs should be large, they can be covered by additional fees assessed "up front" (before the loan is granted).[67]

Loan fees can ease the pain of self-deception for the largest banks.

Gwynne's evidence about the lack of knowledge among the bank's managers for second-line banks can be reinterpreted as a story where they simply are trying to keep their big depositors happy. Makin's discussion of the money-center banks "securing" their loans with LDC government guarantees gives way to the financial advantages of receiving the loan fee. Inadequate knowledge on the part of either set of bankers becomes a matter of secondary importance as does the quality of the loans. This places things a step closer to the case where the bankers rationally may have pushed the loans without expecting significant rates of repayment by the borrowers. Advocates of improved information for the bankers--including access to "special" information on the internal conditions of specific LDCs possessed by the World Bank or the IMF--are barking up the wrong tree if the debt crisis is not due to misinformation on the part of the bankers.[68]

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Keynes explained the manic lending of 1920s by the failure of the bankers to sensibly forecast the future. The bankers, in Keynes' view, were partially the victims of bad advice from his fellow economists who, he continued to argue throughout the 1930s, were misleading practical men with policy recommendations rooted in unsound theory.[69] The bankers also were, Keynes argued, victims of their own penchant for conventions--conventions that paved a path to ruin:

> A sound banker, alas! is not one who foresees danger and avoids it, but one who, when he is ruined is ruined in a conventional and orthodox way along with his fellows, so that no one can really blame him[70]

Better to go down doing what everyone believes a banker should be doing, than to stay afloat by being a maverick in the world of high finance. For Keynes the bankers were prisoners of custom and habit which propelled them onto unwarranted lending sprees from which they eventually recoiled only to deepen their peril. They "pushed" loans--low quality loans--because that was the conventional thing to be doing at the time.

Like virtually all of Keynes' hypotheses this one is intriguing, but it, too, leaves several important questions unanswered: Who sets the convention of the moment? How is it recognized as such, so that the herd follows? If, in fact, there are profit advantages in not following the convention, why does it remain so attractive to follow it to assure that, if failure comes, it comes only "in a conventional and orthodox way"? Or, if the profit advantages from unconventional and unorthodox behavior are supremely uncertain, then why not follow the convention--since to do otherwise holds no assurances of success? In the latter case the bankers are not "blind" to the future and mere victims of their own habitual behavior. They

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may have rationally adopted such habitual behavior to cope in a world that is arational in providing guidance about the future. Indeed, the latter perspective is consistent with much of Keynes' later argument about subjective uncertainty in The General Theory.[71]

C. Principal-Agent Dilemma

A third approach to explaining the debt crisis with loan pushing arises from an application of the problems confronted in the analysis of the relationship between a "principal" and an "agent" in pure contract theory. The principal in this case could be either the senior loan officer or vice president in the commercial bank's home office; the agent would be the junior loan officer working overseas who makes first-hand arrangements for the loan.

The junior loan officers are rewarded by their success in meeting and surpassing assigned loan quotas. They gain by arranging as many loans as possible--loans that must meet with the approval of their superiors. It is to the junior loan officers' advantage to doctor the loan package sufficiently to sell it successfully to those higher up. This may include setting up all manner of "guarantees" from sources in the borrowers' country. But perhaps more important, before the results of any particular junior loan officer's loans are realized, he or she is likely to have moved on to new employment. They are highly mobile participants in the lending industry.[72] The junior loan officers receive high points for bringing the loan package to fruition and few demerits when the loan proves to be of poor quality.

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The principals--in this case senior loan officers or bank vice presidents--have not managed to construct an incentive scheme for the junior loan officers abroad that will extract greater prudence in their efforts to arrange loans. The debt mess, then, is due to a breakdown in the hierarchical operations of the lending institutions.

This is a clever explanation for an international liquidity crisis but probably not a substantive one. It leaves unanswered why the failure to rein in the junior loan officers would be so widespread and persistent as to produce a decade-long accumulation of low caliber loans. Coase's theorem dictates that sooner or later a new scheme of rewards would be designed for the strata of bankers who do the legwork in foreign countries. Sooner or later the results of their lending records even should follow them to new employers.

Presumably, their supervisors--the "principals"-- have strong incentives to get the junior loan officers to stop pushing loans, unless they are of a reliable quality. The penalties for the results of the actions taken by inferiors fall heavily on superiors in the corporate world. For example, the Drysdale and Penn Square Bank incidents led to the removal of two high-level Chase officials and five middle-level executives at Chase Manhattan Bank. In addition, two more vice presidents resigned after news reports identified them as accepting loans generated by Penn Square.[73] Citibank is a bit more benign in its treatment of executives who make decisions that later prove to be bad. Instead of firing those "who show potential" they are removed from decision-making authority (put in the "penalty box") for 12 to 18 months; this clearly slows an executive's rate

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of advancement.[74] In either case, those penalties should have a chilling effect on overexuberant upper-level bank personnel and make them look far more carefully at loan packages brought to them for approval and support.

One can speculate that with such penalty systems in operation for upper-level bank managers, if junior loan officers have had a relatively free hand in arranging foreign loans it must be because those loans do not go as blatantly bad as domestic loans. There has been no publicized major housecleaning of bank personnel over LDC loans as of this time. The aforementioned capacity to roll over foreign loans means indefinite postponement of the day of reckoning. For example, Citicorp Vice-Chairman Thomas Theobald, whose bank has the largest exposure in the Third world continues to maintain that Citibank still makes a profit on its Latin loans. Skeptics suggest that this is due to various steps that have been taken to delay a precipitous mark-down of earnings.[75] It is less likely that it was the actions of the junior loan officers that was as critical as the permissiveness towards those actions by senior bank management.

This points directly at the old puzzle of the objectives of bank management--satisficing or maximizing earnings, satisficing or maximizing shareholder equity, satisficing or maximizing management salaries? To the extent that it is advantageous to bank management, regardless of their objectives, to maintain high and/or rising prices for the banks' equity, the stock exchange may constitute another source of discipline for lending for banks with publicly traded shares. Even if a bank refuses to mark-down their earnings on non-performing loans, well-informed investors still can bear the bank's stock.

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Consider the recent experience of the large U.S. banks with significant exposure to the four largest Latin American borrowing nations (see Table 4)[76] The case of Continental Illinois obviously comes to mind. Its domestic loans, of an unusually low quality pushed the bank over the edge. But there is evidence to suggest that its Latin loans generally were (unofficially) in the nonperforming category.[77] As of late 1982, 11% of its foreign loan portfolio was devoted to Argentina and Mexico, amounting to 3% of the bank's total assets of $37.57 billion.[78] Even before the crushing mid-1984 run on Continental by its major institutional depositors its share prices began a long decline. Its common stock eventually dropped from $25 per share to below $4 per share.

TABLE 4

THE MAJOR U.S. LENDERS TO LATIN AMERICA

	Outstanding loans (Dec. 31, 1983)* Millions of dollars				
	Mexico	Brazil	Argentina	Venezuela	Percent of Total Assets
Manufacturers Hanover	$1,915	$2,130	$1,321	$1,084	10.0%
Citicorp	2,900	4,700	1,090	1,500	7.6
Chase Manhattan	1,553	2,560	775	1,226	7.5
Chemical N.Y.	1,414	1,276	370	776	7.5
J. P. Morgan	1,174	1,785	741	464	7.2
Bankers Trust N.Y.	1,286	743	230**	436	6.7
BankAmerica	2,741	2,484	300**	1,614	5.9
Wells Fargo	655	568	100**	279	5.9
Continental Illinois	699	476	383	436	4.7
First Chicago	870	689	NA	NA	4.3

*Excluding local currency loans **Estimated NA=not available

DATA: KEEFE, BRUYETTE & WOODS INC.

SOURCE: Business Week. June 18, 1984, p. 21.

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The performance of Manufacturers Hanover's common stock appears to carry an even stronger relationship to news about its foreign loan portfolio. A bank with significant exposure in Argentina, it experienced a moderate decline in mid-1982 falling from about $32 per share to $26.50 per share. Whether or not the Falkland Islands crisis played a role in the drop is not clear. This year, however, three Wall Street Journal reporters made a direct link between rumors about the shakiness of Manufacturers Hanovers' foreign loans and its equity position. They emphasized the impact of these rumors in explaining the one day $3.375 drop during May of this year in its share price to $27.625 per share on heavy trading of 1.3 million shares.[79]

Manufacturers Hanover has the largest net exposure to the large Latin American debtors; Citicorp has the largest absolute exposure (again see Table 4). But Citicorp has not experienced as severe a stock battering. It has been suggested that this is due to Citi's strong ability to earn on its domestic operations which are separate from the Latin debt problem.[80] It also may be the case that Citicorp has been more effective in arranging reschedulings among its foreign borrowers--especially in Brazil--to maintain its ability to record high profitability on its loans.[81] In general, lately the LDC loans seem to be having a depressing effect on the large banks' equity positions.

The weakness in money-center banks' share prices has been accompanied by weakness in their earnings. Nineteen major banks reported a loss of $5.6 million during the second quarter of 1984--the only sector of American business to experience an overall loss during the period. The banks' earnings position was overwhelmed by Continental Illinois' $1.16 billion

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negative earnings, a record in the annals of U.S. banking. But removal of Continental from the picture would still leave the remaining 18 banks with a 4% decline in net income. The foreign loan factor played a role, particularly "[s]tricter accounting rules adopted by regulators [that] led the banks to put significant amounts of Argentinian loans on nonaccrual status, reducing earnings."[82]

It appears that the stock exchange only penalizes the banks through their decisions about whether to buy or sell bank stock after news surfaces that the loans are going bad. This news can be "announced" before the banks actually put the loans on nonaccrual status. Nevertheless, downward pressure on share prices from LDC loans seems to materialize fairly late in the game. No such penalties occured when the initial loan commitments were made throughout the 1970s. If anything bank share prices tended to gain throughout the previous decade, and it seems that the stock market's reaction to the development loans was favorable at that time.

If the dominant investors follow the fundamentals in judging whether to bull or bear (or hedge) a stock then they must have been favorably disposed toward the LDC lending boom when it first got underway. They changed their minds in the 1980s when news came in that suggested that all was not well with the loans to the developing world. But, evidently, the market did not forecast that the Latin loans would have an adverse effect on bank earnings in the 1970s.

If the dominant investors are speculators in Keynes' sense then they utilize the news to anticipate the actions of other investors rather than forecast the earnings performance of the banks issuing the securities. In

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this case, bullishness and bearishness will depend upon the various speculative strategies pursued by stock exchange participants.

Regardless of which theory of stock exchange pricing one adopts it appears that the cumulative effect of the LDC loans in the 1970s benefitted bank stock. The cumulative effect of LDC loans in the 1980s has harmed bank stock thus far. Whether or not the net effect over the course of an entire 15-year period has been advantageous or disadvantageous is an empirical question which will not be resolved here.

Suppose further study indicates that all the news about the loans--despite the recent news that identifies problems with them--has had a positive effect on bank stock. Also suppose that bank managers want to raise the value of their enterprise's equity, and suppose they could have anticipated that the stock exchange on balance would provide a favorable assessment of their LDC loans. Then it is reasonable to argue that the existence of a stock exchange facilitated loans to the periphery rather than impeding them. To the extent that maintenance of high share prices matter to bank management, ceteris paribus, it would have been perfectly rational for senior loan officers to let their employees out in the field push loans. Of course, the jury is still out on what additional news about the Latin loans will be forthcoming and about the stock market's future reactions to such news.

D. Overborrowing

A fourth approach to the international debt crisis shifts the responsibility onto decision makers in the borrowing countries. The borrowers simply absorbed an unreasonable amount of debt. This could have been due to the

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lack of good sense about policymaking to achieve growth via borrowing on the part of LDC finance ministers. Or it could be due to entirely sensible judgments by national leaders, given their personal political objectives and the tenuousness of their tenure of leadership. Nations may continue to exist, as Citicorp's executives always point out, but regimes can change--sometimes quite rapidly. A large debt burden can be passed on to the successor regime as a problem for them to solve, while the accumulation of debt may have resolved a variety of other problems faced by the regime incurring the debt. For whatever reason the borrowing countries failed to follow Yves Maroni's instructions on "How to Borrow Reasonably."[83] This approach is the most fiercely incompatible with loan "pushing" by the banks.

But overreaching for credit by borrowing nations actually throws the ball back into the lenders' court. If the world really follows Irving Friedman's description, where banks are passive actors waiting patiently for potential borrowers to appear on their doorstep, the banks still have the option of denying applications for loans from borrowers whose prospects for repayment are dubious. It is possible that the potential borrower will provide individual banks with false information, especially about how many other banks from whom it has obtained funds. But this presses the argument back to the position that bankers acted out of ignorance. Moreover, ignorance about the other banks who have made loans to an overextended borrower is less likely when commercial bank loans have been made through wide-ranging syndications.

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E. The Financial Instability Hypothesis

Hyman Minsky recently has begun the extension of his financial instability hypothesis to the foreign loan push of the 1970s.[84] The financial instability hypothesis mandates that the credit mechanism of capitalistic economies is inherently prone to breakdown, contributing directly to recurrent cyclical downturns.[85] Cast in the context of a long-wave analysis, Minsky contends that long periods of prosperity lead lending institutions to extend credits to borrowers with increasingly weaker financial positions. Profit-seeking enterprises that receive new credits are more leveraged than their predecessors in the borrowing game and more vulnerable to being unable to repay their debts when a decline occurs in after-tax profits. Older borrowers taking on additional credit, at least in part to refinance previous debt obligations, acquire less sturdy financial postures. Eventually a dropoff in after-tax profits occurs, and businesses fail to meet their payment commitments. The lenders subsequently retreat from extending additional credit. The credit crunch that supplants the prior credit boom propagates a generalized fall in investment, income, and employment.

It is convenient to graft a new set of borrowers onto the Minsky model, specifically foreign borrowers in developing countries. They become the object of attention of lenders to a greater degree as the long upswing advances. This group of borrowers may, from the time their loans first are contracted, possess speculative or Ponzi finance positions. These positions are the most dangerous to sustain in a Minsky world.[86] The longer the duration of a cyclical upturn, the larger the proportion of businesses and, now, foreign governments, who come to hold these more dangerous positions.

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Since Minsky seems to view these long waves culminating in near-manic lending booms as occuring cyclically, they are events that repeat themselves periodically.[87] The upswings in chronological time appear to be relatively long from a business cycle perspective--perhaps forty to fifty years. But if Minsky has detected the periodicity in these events, why have the bankers failed to do so? Why do they repeat the overlending practices that have contributed to major downturns in past? Why have they not learned from the mistakes of the 1920s, for instance?

This is virtually the same as asking, why do the bankers fail to display behavior rooted in rational expectations if the Minsky model provides an accurate picture of the structural features of the U.S. economy. Of course, if holding rational expectations means that they adopt more conservative lending practices during a long upswing then the process Minsky depicts would not happen. To maintain the Minsky position it is more satisfying to establish that the credit cycles could occur even if bankers could foresee the adverse consequences of their collective actions.

Minsky tends to argue that the bankers believe their loans would perform, but individually they cannot manage the performance of the world economy. Policy makers, like the Federal Reserve could avert the credit crunch, but to do so would require reflation of the economy. Furthermore, the bankers and the Fed officials alike are prisoners of the false doctrines of monetarism which purports to argue that if the Fed maintains steady money growth the economy will be self-adjusting or self-correcting.[88]

The first part of his argument can take on the flavor of the version of the rational expectations approach that says the bank loans went bad due to the random shock of the Fed's disinflation policy. Otherwise, if

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the Fed had continued an easy money policy the debt crisis may never have materialized. For Minsky, the cyclical fluctuations are characteristics of the unregulated capitalistic economy; appropriate regulation will eliminate the cyclical swings.

Without regulation, competitive pressure among the banks leads them to extend loans to less and less well-secured borrowers. Even if there are lessons to be learned from past lending booms, the profit wars of today place an insuperable impetus on the commercial banks to increase their assets through new lending. If it fails to "keep up," a bank must accept a lower rate of return than its competitors during the long upswing as the price paid for greater stability in its performance.[89]

Finally, it is worth noting--especially in light of the section that follows--that certain regulatory policies might aggravate overlending. If the Fed, for example, performs its lender of the last resort function without any major quid pro quo from the rescued financial institution, it only would serve to encourage others to continue making injudicious loans:

> If lender-of-last-resort interactions are not accompanied by regulations and reforms that restrict financial market practices, then the intervention sets the stage for the financing of an inflationary expansion, once the 'animal spirits' of business people and bankers have recovered from the transitory shock of the crisis that forced the lender-of-the-last resort activities in the first place.[90]

F. Moral Hazard

The previous observation by Minsky succinctly identifies the moral hazard problem. To the extent that lenders perceive that there are institutions willing to "insure" their operations they may become more willing

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to pursue loan options that they might avoid otherwise. The banks do have an insurance scheme embodied in the Federal Deposit Insurance Corporation and the capability of the Federal Reserve to perform a lender-of-last-resort function.[91]

What makes loans to LDC borrowers unique is the potential "insurance" provided by the IMF. For although the banks cannot control how the funds are used by sovereign borrowers when loans are contracted initially, the IMF can perform the task for them when the borrower runs into balance of payments difficulties and is turned toward the Fund for "relief."[92] Whether or not the Fund's conditionality criteria truly alleviates a country's debt and/or payments problems is a hotly debated topic, but the Fund has the ability to supervise the debtor nations' use of funds in a way that the commercial banks themselves cannot.

The existence of insurance schemes of this sort pose the moral hazard problem--"the existence of the insurance may have the particularly perverse effect of increasing the incidence of the contingency being insured against--bank failures in one case and burglaries in the other."[93] Insurance against the consequences of bad loans may increase the incidence of bad loans.

But does the insurance protect the decision makers within the bank who make the loans? Do the bank managers gain security from the FDIC and Federal Reserve back-up capabilities or is it merely the depositors who receive protection? When Continental Illinois' senior management finally surrendered on efforts to find a private institution to inject new funds into their bank, they turned as a "last-resort solution" to the FDIC. Part of the bail-out plan designed to keep the institution afloat involved the

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removal of Continental Chairman David Taylor, as well as other senior managers, and their replacement by officials selected by the FDIC. Continental's stockholders also would take a bath. In addition to the plunge in Continental stock they already had weathered, they "could lose the largest share of some $2.2 billion in equity [when] the Government takes over."[94]

In the case of Continental, as in the case of Franklin National ten years earlier, the regulators protected the depositors. In fact, for a bank that had experienced a run so severe that perhaps as much as two-thirds of its $30 billion in deposits had been removed since May, the FDIC promised to protect depositors of sums larger than its $100,000 legal limit.[95]

Although individual bank officials are not free from jeopardy when loans sour, the bank as a going enterprise is protected from failure. To be precise, a large money-center bank is protected from failure, particularly those with intricate inter-bank deposit arrangements. The Continental rescue was outright, unlike the still unsettled demise of Penn Square Bank. The Continental rescue seems to provide a clear signal to the larger banks--and their depositors, inclusive of other large banks--that they will continue to exist regardless of the decisions of their present array of senior managers. As least, such security exists up to the limits of the FDIC's insurance fund.[96] Even in the case of exhaustion of the FDIC's funds, the Fed could step in and substantially expand the reserves of the private banks. Of course, as Minsky has stressed this would mean the Fed would have to accept the inflationary consequences of such a move.

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In summary, there is ambiguity about the scope of the moral hazard problem. The FDIC's insurance capability does not preclude the collapse of second line banks. It does preclude collapse of the large money-center banks. However, this guarantee does not extend to job security for the large bank officials nor the asset position of the large bank stockholders.

The Fed's lender-of-the-last resort capability carries no similar repercussions for senior bank officials. Perhaps this was the true reason for the bankers' "surprise" (if, indeed, they were surprised by the Fed's post 1979 actions): the Fed's adamant disinflationary stance undercut "insurance" they had counted on when loans were contracted initially. The Fed would not "validate" the debts as long as it steered a course away from inflation. Temporarily, the Fed still could lend to the debtor nation directly as it did for Mexico.

As noted above, foreign loans possess a unique advantage, given the ability and willingness of the IMF to supervise nations whose governments encounter difficulties in making loan payments. Reliance upon the IMF as an insurance agent on foreign loans involves a high degree of brinksmanship on the part of the commercial banks. Not only must the banks believe that the IMF's conditions for new lending are the correct ones, but they also must believe that LDC regimes can contain the political reaction of their citizens to national debt peonage that often is aggravated when the Fund comes on the scene.[97]

G. Finance Capital

The final approach explaining the debt crisis to be considered here emerges from the implications of Rudolf Hilferding's views on the secular consequences of competition under capitalism. Hilferding argued that

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financial institutions, especially banks, would play a growing coordinating role over industry--that the directors of financial and industrial enterprises would overlap to an increasing degree. Over time, the competitive nature of capitalism would lead to crises arising out of overlending-cum-overborrowing of a sort quite similar to Minsky's. The periodic downturns would involve shakeouts that would extinguish smaller businesses and produce greater concentration in both the financial and industrial spheres. The stage of finance capital was the era in which this tendency toward concentration under capitalist competition became urgently visible.[98]

It is notable that in the 1930's when thousands of U.S. banks permanently closed their doors the survivors included Citicorp, J. P. Morgan, Chase Manhattan, and Bank America.[99] It also is of interest that, with the exception of Continental Illinois, the current wave of bank failures has left the giant money-center banks untouched.

Whereas Hilferding developed his theory of the evolution toward greater concentration in an analytical environment of pure laissez-faire capitalism, there are reasons to believe that the contemporary regulatory apparatus promotes the position of the larger banks. The previous section of the paper indicated that the FDIC's rescue of Continental Illinois shows that the big banks can expect a degree of help that will not be given to smaller banks. This could give the big banks a further advantage in attracting depositors over the smaller banks and other deposit-accepting financial institutions.[100] Even if small bank depositors do not pull their funds out entirely and, instead, diversify by placing their funds with several banks, this still could hurt the banks that previously held their entire deposits.

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Already, the shift is on toward the transfer of deposits from smaller banks to larger banks.[101] Although the FDIC's rescue operation for a large bank that fails can lead to dismissal of bank officials, the demonstration effect can have great benefits for the large banks that are still solvent. The policy can induce a shift in depositors toward them, enhancing concentration of bank resources.

Regulatory proposals now under consideration to increase disclosure may have a differential effect with respect to banks of different sizes. In terms of domestic loans the "large banks whose shares are publicly traded already disclose considerable information through the Securities and Exchange Commission's reporting system" while the smaller banks would have to surrender new information that they fear could subject them to runs by an already panicky public.[102] The larger banks, with a larger proportion of their portfolio in foreign loans, potentially can preserve the illusory quality of those loans more easily than the smaller banks can with their problem domestic loans.

It already has been shown that the large money-center banks have a clear gain in the foreign loan business from the large fees they obtain for arranging a syndication. When nervousness about LDC loans sets in smaller banks tend to be the first to seek to pull back.[103] The larger banks have an incentive to keep the second-line banks involved in new lending efforts to extract the loan fees.[104] But if they cannot keep them involved they still can take over some of the smaller banks' claims when the latter pull out from providing funds to a country having payments difficulties.[105] One can speculate that the larger banks absorb these claims from those in

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flight at a reduced price, and the smaller banks must correspondingly write-down their asset position.

There may be a general principle that emerges here: periods of generalized crises of liquidity permit the larger banks to gain at the expense of the weak.[106] Although the larger banks are rivals among themselves, in general international debt crises serve them collectively vis-à-vis the rest by producing the conditions under which they can consolidate their position. If they are, at least in part, conscious actors in this process, they may push LDC loans to advance such concentration.

CONCLUSIONS

If bankers possess rational expectations and made loans to LDC borrowers sensibly based upon their best possible forecasts given the available information, then three options follow in explaining the international debt crisis. Either (1) there is no crisis--an extremely difficult position to sustain, (2) the crisis was the product of an unanticipated event--such as the change in monetary policy that occurred in 1979, or (3) the bankers knowingly made bad foreign loans.

The third position can be maintained--despite its peculiarly cynical flavor--if one distinguishes carefully between the potential interests of the large money-center banks whose shares are publicly traded and the comparatively smaller banks that are not publicly owned. The latter, it can be argued, were pressed into the foreign loan business by the efforts to export abroad by their major depositors. It should be added that larger banks, through correspondent relationships, can exert leverage to pull them into foreign loan syndications.

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There are a variety of reasons why foreign loans potentially are of special benefit to large money-center banks, regardless of loan quality. First, the money-center banks can obtain loan fees up front for setting up the syndication. Second, the regulatory climate permits foreign loans to be kept on the books as performing far longer than domestic loans when borrowers are in arrears. Third, when smaller banks withdraw from syndications when problems appear the larger banks can absorb their claims, presumably at a lower cost than the price of the initial commitment. Fourth, foreign loans to LDCs have potential international insurance agents, for example, in the form of the IMF. The World Bank also appears to be taking on more of this type of function lately. Fifth, LDC loans can contribute to an overall climate of financial pressure that facilitates greater large bank dominance of the banking industry--in part because of the way in which regulators respond to the crisis. Sixth, there might be a net gain on the stock market from the foreign loan commitment, depending on market participants reaction over time to the loan.

Loan pushing is most consistent, within the context of the rational expectations hypothesis, with this third possibility. This third possibility--bankers opting to contract for loans having a high probability of going bad--rests heavily on the existence of public sector institutions that the bankers anticipate will function as "guarantors" in their stead. The Minsky position augments the incentives for lending brought on by the existence of these back-up institutions with competitive pressure. Based upon evidence from the earlier lending waves to the less-developed countries,

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prior to the existence of FDIC or the IMF or the World Bank, competitive pressure á la Minsky may well be a sufficient condition on its own terms to produce a debt crisis. But the modern regulatory apparatus might make it easier for the bankers to forget any lessons to be learned from the past. Only the Minsky approach explicitly offers an explanation that suggests why waves of lending occur at long intervals.

Loan pushing also is, obviously, consistent with arguments that are not constrained by the assumption that bankers possess rational expectations. Inadequate information on the part of the bankers, or the related explanation that attributes the debt crisis to flaws in the incentives prevailing in the typical organizational structure of banks both could result in overlending. But these explanations are less satisfactory because they are rooted in circumstances that are unlikely to be stable or persistent. Presumably, bankers themselves would have an incentive to improve their information or to remedy institutional weaknesses that produce an excessive volume of bad loans--if, indeed, they are concerned about loan quality.

Regardless, the idea that banks "push loans," in the Brimmer-Kindleberger sense, is not an unreasonable one. The history of commercial bank lending to the less developed regions generate a host of instances that conform with the general characteristics of the loan push phenomenon. A variety of theoretical approaches provide credible explanations for the phenomenon.

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FOOTNOTES

*Distinguished Visiting Professor of Economics, University of Tulsa and Associate Professor of Economics, University of North Carolina at Chapel Hill. This paper was presented at a conference on The World Debt Crisis held at Middlebury College in September 1984. The author has benefitted from comments, criticisms, and suggestions from Ed Green, Bobbie Horn, Charles Kindleberger, Jeffrey Marquardt, Rodney Mills, and Guy Stevens. The author also is grateful to the Board of Governors of the Federal Reserve for providing him with support as a visiting scholar to extend this research effort. This paper represents the views of the author and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or other members of its staff.

1. Irving Friedman. "Emerging Role of Private Banks," in Stephen S. Goodman (ed.). Financing and Risk in Developing Countries. New York: Praeger, 1978, pp. 19-24.

   For example, Friedman (p. 20) writes ". . . the response of the banks is the response to a demand. Bankers do not make loans to countries, or entities within countries, that do not ask for a loan. The fact is that someone comes to a bank and asks for a loan. Then the banker judges whether to do it. Banks compete for attractive loans, but the borrower is essentially the genesis of the loan." And also (p. 20): "It is sometimes said that banks are 'reaching' for loans. This is a concept that is often found, even in periodicals which are considered friendly to the private banks. I do not think it is right."

2. Max Winkler. Foreign Bonds: An Autopsy. Philadelphia: Roland Swain Company, 1933, pp. 86-7.

3. Ibid., p. 87.

4. Ibid., p. 47.

5. Ibid., p. 47.

6. Ibid., p. 47.

7. Ibid., pp. 87-8.

8. Cleona Lewis. America's Stake in International Investments. Washington, D.C.: Brookings, 1938, pp. 377-8.

   The history of lending to Cuba was especially notorious. For details on the "dance of the millions" see Leland Hamilton Jenks. Our Cuban Colony. New York: Vanguard Press, 1928 and Henry Wallich. Monetary Problems of an Export Economy: The Cuban Experience 1914-1947. Cambridge: Harvard University Press, 1950.

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9. Lewis, Ibid., p. 378.

   Lewis offered the examples of (1) Ulen and Company's contract to build the port works in Colombia, (2) Frederick Snare and Company's financing of public works contracts in Peru, (3) Warren Brothers road-building contracts in Argentina, Chile, Colombia, Cuba, and Guatemala, and (4) Foundation Company building roads, sanitation works and public works in Peru and Bolivia and public works in Argentina, Chile, and Colombia. She does not detail the extent to which the contracts were fulfilled completely.

10. Ibid., p. 379.

11. Ibid., p. 379.

12. Henry Wallich. "The Future of Latin American Dollar Bonds," American Economic Review. Vol. 33:2, June 1943.

    Wallich (pp. 326-7 emphasis added) observed, "It was pointed out by Professor Hansen in his testimony before the Temporary National Economic Committee that the American prosperity of the 1920's was due not to any inherent characteristics of our economic system but to the cooperation of a number of stimulating factors. One of these factors was the high level of our exports, paid for in part with the proceeds of our loans. It cannot, of course, be proved that the loans increased exports by an equal amount. Since, however, most countries had only limited exchange reserves of their own, insufficient to permit a continuously passive current balance, a fair presumption exists that the increase in exports was roughly equivalent to our loans. These additional exports produced an export multiplier effect and thus tended to raise national income by a multiple of their own value. From this gross gain in national income we must of course deduct the losses suffered through the default of the loans, in order to arrive at the net gain attributable to the loans. But these losses have been smaller than the loans themselves, since the defaulted bonds still retain some market value. Hence their subtraction from the gross gains, which were larger than the loan-induced exports (which we have assumed to be equal to these loans), still leaves a considerable margin of net gain for the United States." Wallich's comments indicate that foreign lending can be analyzed in terms of the transfer problem so popular in the pure theory of international trade.

13. Ibid., p. 327n. 4.

14. Winkler, op. cit., p. 88.

15. Lewis, op. cit., passim.

16. Wallich, op. cit., pp. 322-3.

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17. There is some controversy over why the transition has taken place from bond finance to bank loan finance. In an excellent survey of the literature on international capital markets and dynamic contract theory Vince Crawford has identified one argument--attributable to Sachs and Cohen--as the claim that there are "increased benefits of renegotiation in response to debt crises." Such renegotiations are ruled out in the case of bond finance "because of the large number of bond-holders whose consent would be required." Crawford muddies the waters a bit for this explanation by pointing to Hellwig's finding that there also can be benefits associated with a "precommitment not to renegotiate in some circumstances . . . ." Crawford concludes, ". . . in general, the superiority of bank lending over bond lending depends on the relative importance of default-risk moral-hazard problems and uncertainty that cannot be dealt with adequately by contingent contract." Bond lending actually might be superior in an environment where "moral-hazard problems predominate," making it desirable to minimize reschedulings. See Vincent Crawford, "International Lending, Long-Term Credit Relationships, and Dynamic Contract Theory," Discussion Paper 84-14 University of California, San Diego 1984 pp. 33-4. Crawford's discussion, rooted in all the best presumptions of modern economics, suggests that one should seek an explanation for the transition in terms of collective rationality of the market. Charles Kindleberger, on the other hand, has indicated in correspondence that the explanation for the transition lies in (1) investors' continued skittishness about low grade foreign dollar bonds, (2) the impact of the Glass-Steagall Act of 1936 that separated commercial and investment banking, (3) the impact of the Interest Equalization Tax over the interval 1963 through 1974, and (4) the general preference of Euro-currency banks for sovereign loans over Euro-bond issues. My colleague Bobbie Horn suggests that the latter preference might be shared on both sides of the loan contract due to the greater flexibility associated with shorter term commitments.

18. T. H. Donaldson. International Lending By Commercial Banks. New York: Wiley and Sons, 1979, p. 159 emphasis added.

19. Charles P. Kindleberger. Manias, Panics, and Crashes: A History of Financial Crises. New York: Basic Books, 1978, pp. 23-4 emphasis added.

At least by early 1978 Kindleberger already perceived that the foreign loans might be "going bad." He wrote on p. 24 of his book, "Some of the chickens have already come home to roost, in defaults by Zaire and Peru; others, such as Petamina in Indonesia have had close calls." And the following passage appeared in an article by Peter Field, David Shirreff, and William Ollard "The IMF and Central Banks Flex Their Muscles" Euromoney January 1983 p. 1: "'They[the banks] lent $12 to 15 billion to Mexico over 12 to 15 months when the situation was clearly going wrong,' gloated an American monetary source. And even a senior banker in Luxembourg was prepared to ask: 'Who should be punished more? The addict, or the money-pusher?'"

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20. This perspective is apparent in the remarks of such disparate observers as then Federal Reserve Board Governor Andrew Brimmer in "International Capital Markets and the Financing of Economic Development" in Addresses, Essays, Lectures of Andrew Felton Brimmer Vol. 13 Washington, D.C.: Federal Reserve Library 1973 p. 17, Cheryl Payer "Will the Government Bail Out the Banks?" The Bankers Magazine Vol. 160: No. 2 Spring 1977 p. 84, and Stephen I. Davis The Management Function in International Banking New York: John Wiley and Sons 1979 pp. 19-20. Brimmer, for example observed "The main explanation [for the sharp rise in bank lending to the LDC's] appears to lie in the abundant supply of funds to the Euro-dollar market and the failure of demand for loans from borrowers in developed countries to keep pace with the expansion in credit availability." And further: ". . . the Euro-currency banks (especially in London) began to push loans to the developing countries with considerable vigor."

21. In his Westerfield address delivered at Atlanta University on October 25, 1973--prior to the bite of the first oil "shock"--Brimmer, Ibid., p. 15, said that the seeds already had been sown for an international debt crisis: ". . . there was a growing awareness in the late 1960s and early 1970s that the developing countries as a group, had incurred very large foreign debts and were faced with heavy debt service requirements in the years ahead." As early as 1969, Brimmer (p. 16) noted, that a Commission on International Development headed by Lester Pearson warned about difficulties posed for short and long term debt management problems for LDCs. The World Bank in its World Debt Tables: External Public Debt of LDCs December 15, 1974 (p. xvii) reported that by the late 1960s and the early 1970s several countries already were "unable to continue meeting their debt servicing obligations." These included Chile, Ghana, India, Indonesia, Pakistan, Peru, and Turkey seeking debt relief on a multilateral basis and Afghanistan, Egypt, and Yugoslavia seeking relief on a bilateral basis.

22. Davis, op. cit., pp. 23-5.

    Davis provides estimates that indicate that from the end of 1974 to the end of 1977 banks in the Group of Ten countries and Switzerland raised their net exposure in Brazil by 335%, in Mexico by 317%, in South Africa by 197%, in the Soviet Union by an astonishing 8457% (although the initial base was negligible), in Poland by 284%, and in Peru by 285%.

23. S. C. Gwynne. "Adventures in the Loan Trade." Harper's, Vol. 267:1600, September 1983, pp. 22-6.

24. Ibid., pp. 25-6.

25. Ibid., p. 26.

26. Steve Frazier. "Oil's Lure Led Mexico and Banks Into Payment Woes," Wall Street Journal. May 15, 1984, p. 32 emphasis added.

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27. See, e.g., "A War of Nerves Over Latin Debt," Business Week. June 18, 1984, pp. 20-1.

28. Brimmer, op. cit., p. 17.

29. Charles Kindleberger, correspondence dated July 6, 1984.

30. Ibid.

31. A simple explanation for the commercial banks' movement toward LDC borrowers could be the claim that the elasticity of loan demand by center borrowers is much greater than the elasticity of demand by borrowers from the periphery with respect to the terms. Therefore, a point is reached on a phase of loan expansion when the commercial banks perceive that they will have to make unacceptably large reductions in the terms to continue lending at the center. But the Kindleberger view has the banks having to accept softer terms at the center for any reason, including central bank monetary policy.

32. Michael Beenstock. The World Economy in Transition. London: George Allen and Unwin, 1983.

33. Ibid., p. 122.

34. Lawrence G. Franko. "Debt, Trade, and the Prospects for World Economic Growth," in L. G. Franko and Marilyn Seiber (eds.). Developing Country Debt. New York: Pergamon Press, 1979, p. 292.

35. Paul Volcker. "How Serious Is U.S. Bank Exposure?" Challenge. Vol. 26:2, May-June 1983, p. 13.

36. Laurie Goodman. "Bank Lending to Non-OPEC LDCs: Are Risks Diversifiable?" Federal Reserve Board of New York Quarterly Review. Vol. 6:2, Summer 1981, p. 20.

37. Charles Kindleberger. "Debt Situation of the Developing Countries in Historical Perspective" in Stephen Goodman (ed.). Financing and Risk in Developing Countries. New York: Praeger Publishers, 1978, p. 6.

38. Joël Metais. "Less Developed Countries' Rising Indebtedness and the Lender of Last Resort in International Context" in C. P. Kindleberger and Jean-Pierre Laffargue. Financial Crises: Theory, History, and Policy. Cambridge: Cambridge University Press, 1982.

Metais (p. 222) contends that the 1970s constitutes the fifth wave of lending to the "backward" regions. He (p. 234n.2) identifies the periods 1817-1825, 1860-76, 1900-14, and the 1920's as the four previous waves. "Unfortunately," Metais (p. 222) concludes, "they all ended in widespread defaults." Some of the same countries were involved in the lending booms in the latter three waves--1900-1914, 1920s, and 1970s: Argentina, Brazil, Egypt, Mexico, Spain, and Turkey.

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39. Henry Wallich. "How Much Private Bank Lending Is Enough?" in Stephen Goodman (ed.) Financing and Risk in Developing Countries. New York: Praeger Publishers, 1978, p. 15.

40. Ibid., pp. 15-6.

41. Ibid., p. 16.

42. See Crawford, op. cit.

43. Stephen M. Dubrul Jr. "Management of Risk" in Stephen Goodman (ed.). Financing and Risk in Developing Countries. New York: Praeger Publishers, 1978, p. 57.

44. J. M. Keynes. "The General Theory of Employment," Quarterly Journal of Economics. February 1937, p. 214 emphasis added:

"By 'uncertain' knowledge, let me explain, I do not mean merely to distinguish what is known for certain from what is only probable. The game of roulette is not subject, in this sense, to uncertainty; nor is the prospect of a Victory bond being drawn. Or, again, the expectation of life is only slightly uncertain. Even the weather is only moderately uncertain. The sense in which I am using the term is that in which the prospect of a European war is uncertain, or the price of copper or the rate of interest twenty years hence, or the obsolescence of a new invention, or the position of private wealth-owners in the social system in 1970. About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know."

45. Neil J. McMullen. "Historical Perspectives on Developing Nations' Debt" in Lawrence G. Franko and Marilyn Seiber (eds.) Developing Country Debt. New York: Pergamon Press, 1979, pp. 3-16.

McMullen also was an optimist about the LDC debt build-up of the 1970s based upon a comparison with the conditions of the 1930s. His comparisons may have been, like Beenstock's, premature. The only salient differences between the 1930s and the current situation that McMullen identified that still applies is the existence of international institutions that can make concessionary loans and grants, and because of loan finance instead of bond finance countries with debt problems may have more alternatives to formal default.

46. Michael Dooley, William Helkie, Ralph Tryon and John Underwood. "An Analysis of External Debt Positions of Eight Developing Countries Through 1990," International Finance Discussion Paper No. 227, Board of Governors of the Federal Reserve System, August 1983, p. 7.

47. Ibid., p. 7.

48. Ibid., p. 7.

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49. Ibid., p. 7.

50. G. Christian Hill. "Lender Beware: List of Troubled Banks Shows Realty, Energy Lead Bad-Loan Areas," The Wall Street Journal. March 19, 1984, p. 1.

51. John H. Makin. The Global Debt Crisis: America's Growing Involvement. New York: Basic Books, Inc., 1984, p. 135 emphasis added.

It is interesting to note that the initial loan contracts included a contingency clause--the sixty day nonperformance clause--but that the banks effectively recontracted with the Brazilian borrowers by extending the nonperformance clause to ninety days. At first blush, recontracting may appear to be incompatible with the behavior associated with invocation of rational expectations on the part of the bankers. But in the context of strategic gamesmanship where both partners to the contract--lender and borrower--must form expectations about the other's reactions, the possibility of renegotiation and recontracting can mute the moral-hazard problem. See Crawford, op. cit., pp. 19-42.

52. See Lawrence Rout. "Banks Want Interest From Mexico Firms: Institutions Threaten to Bar New Government Loans Unless Debt Is Paid Off," Wall Street Journal. November 24, 1982, p. 30 and "Mexico Arranges Over $4.8 Billion In Loans For 1983," Wall Street Journal. February 9, 1983, p. 34.

53. Lawrence Rout. "Mexico's Debt Load Troubles Banks," Wall Street Journal. April 21, 1983, p. 33.

54. Jane D'Arista makes a similar point in "Private Overseas Lending: Too Far, Too Fast?" in Jonathan D. Aronson (ed.). Debt and the Less Developed Countries. Boulder: Westview Press, 1979, pp. 69-70:

"Despite fiascoes in Indonesia and elsewhere, some analysts argue that banks have not been reckless in their LDC lending. They cite as evidence a Federal Reserve Board study showing that loan loss experience on foreign loans has been significantly lower than on domestic loans. An obvious question arises: Is it possible that the same banks that lent $22 billion to REITs were miraculously more prudent when lending to foreigners? Albert Fishlow suggests that this could be so if banks are more willing to accept losses on domestic portfolios than on foreign. Domestic bankruptcy laws offer some protection unavailable abroad, especially where governments are involved. It may be rational for banks to accept refinancing or rescheduling of foreign loans rather than default.

"Thus, evidence of problems in international lending may lie elsewhere. The Securities and Exchange Commission has, in fact, turned over a stone ignored by other bank regulatory authorities. It requires bank holding companies to report aggregate nonperforming loans and sometimes has pressed banks to break out these loans by source and state

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their earnings' impact. At the end of 1976, a few U.S. multinational banks reported nonperforming foreign loans at levels almost as high as those for domestic borrowers. While much more information is needed to assess the source of international lending problems, it is clear that loan loss experience is an inadequate measure of foreign lending prudence."

55. Daniel Hertzberg and S. Karene Witcher. "New U.S. Rules On Latin Debt To Affect Banks." Wall Street Journal. June 19, 1984, p. 3.

56. Ibid., p. 3.

57. For example, Manufacturers Hanover with heavy exposure in Latin America experienced a major "battering" of its stock in 1984, well before the regulators took steps to encourage more stringent accounting practices.

58. Thomas O. Enders and Richard P. Mattione. "Latin America: The Crisis of Debt and Growth." Brookings Discussion Papers in International Economics. The Brookings Institution. December 1983, p. 24.

Enders and Mattione also argue that the situation was made worse by the failure of the Latin debtor nations' regimes to engineer an "adjustment" to their balance of payments difficulties. "Adjustment" is a euphemism for the austerity of reducing consumption and imports. Of course, this leaves open the issue of who will bear the burden of "adjustment"--the wealthier strata of the debtor nation or the poor. There are sound reasons for believing that the brunt will be felt by the poor when such "adjustments" are enacted--particularly after a "successful" visit by an IMF mission.

59. Richard S. Dale. "Country Risk and Bank Regulation," The Banker. Vol. 133:685, March 1983, p. 46.

Makin, op. cit., p. 142 observes, "The argument for diversification was compelling--but not, it turned out, compelling enough to overcome two very serious problems. First, it overlooked the ability of governments to spend more than they have no matter how much they have. In this case governments proved to be wasteful intermediaries between banks and projects, out of carelessness or incompetence and sometimes out of downright dishonesty. Second, it forgot that the diversification argument relates only to the stability of earnings, not their level. The sad truth is that if a world recession--like the one that began in 1981--unites with waste to produce a widespread negative rate of return, it does not help much to have diversification to thank its being a stable negative return instead of a volatile negative one. The debts still cannot be repaid." (emphasis in original).

60. See Jeffrey Sachs. "The Current Account and Macroeconomic Adjustment in the 1970s," Brookings Papers on Economic Activity. 1981 and Michael Bruno and Jeffrey Sachs. "Adjustment and Structural Change in the World Economy," NBER Working Paper No. 852, 1982.

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James Street also has argued that the Latin American debt situation is entirely due to oil shocks. See his paper "The Latin American Debt Problem: Liquidity or Growth Crisis?" unpublished manuscript Rutgers University, December 1983.

61. Makin, op.cit., p. 152.

62. Gwynne, op. cit., p. 23

63. Ibid., p. 23.

64. Ibid., p. 23.

65. Ibid., p. 23.

66. Makin, op. cit., p. 139.

Gwynne, Ibid., p. 26 also describes how he put the ribbon and bow on his Philippine loan by arranging a guarantee on the loan from a Philippine bank that was "handing them out . . . like free samples."

67. Makin, Ibid., p. 139.

68. See, e.g., Robert Slighton. "Improving Country-Risk Judgments," The Chase Economic Observer, Vol. 3: No. 4, July/August 1983, pp. 3-4.

Slighton argues that improved information would enhance the quality of bank lending decisions to borrowers in foreign countries.

69. J. M. Keynes. "The Consequences to the Banks of the Collapse of Money Values (Aug. 1931)," Essays in Persuasion. New York: W. W. Norton & Company, 1963, pp. 176-7.

The bankers, Keynes observed, were "blind" in their support for deflation--a deflation which would accelerate "if a really conservative valuation were made of all doubtful assets [the] proportion of the banks of the world [to] be found to be insolvent . . . ."

70. Ibid., p. 176.

71. J. M. Keynes. The General Theory of Employment. Interest, and Money. London: Macmillan, 1936, especially Chapter 12.

72. For example, the ubiquitous S. C. Gwynne, op. cit., p. 26 was long gone from his Midwestern bank when his Philippine loan went bad.

73. "Chase Reports Operating Loss for 2nd Quarter," The Wall Street Journal, July 21, 1982, p. 2.

74. Daniel Hertzberg. "Banking Behemoth: Citicorp Leads Field In Its Size and Power--And In Its Arrogance," Wall Street Journal, May 11, 1984, p. 1.

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75. Ibid., p. 16.

76. The Latin American debt far exceeds the indebtedness of any other region of the Third World. For example, by mid-1984 the total debt of the Latin nations was estimated to be greater than $230 billion when compared with the estimated debt of about $50 billion for all of Africa's nations. This does not mean that the situation in terms of debt management is any easier for the African countries. The smaller magnitude of the African debt removes the leverage the Latin nations possess to threaten the formation of a debtor's cartel. For several African nations debt service ratios exceed those of Mexico and Brazil. Plus virtually all African nations have severe balance of payments problems. See Clifford D. May. "Africa's Debts Appear More Troublesome Than Others." The New York Times, July 1, 1984, p. E 3.

77. Lee Berton "Early Warnings: Long Before the 'Run' at Continental Illinois Bank Hinted of Its Ills," The Wall Street Journal, July 12, 1984, p. 20 reports:

". . . Continental's loans--the main assets at the Chicago institution are of poorer quality than its competitors', the banks' most recent financial reports show. At the end of the 1984 first quarter, for instance, Continental's nonperforming loans--those 90 days or more past due on interest and principal--were 7.7% of its total loans, compared with 2.7% for the 14 money-center banks. Continental's loan-loss reserves rose to 1.32% of its total loans at the end of the quarter from 1.21% at the end of 1983 and 1.11% [at] the end of 1982." Berton also quotes bank accountants as describing Continental as being "notorious in the industry for 'shooting craps' by lending to companies that other banks avoided." The bank's customers had included "once-ailing Chrysler Corp. International Harvester, and Braniff International Corp.," but it still was hesitant to raise its loan-loss reserve significantly. In fact, between 1975 and 1981 it lowered the reserve from 1.34% to 0.87% while other money-center banks typically maintained a 1% figure. Continental also had a remarkable record in lagged writeoffs. After the 1982 shut down of Oklahoma City's Penn Square Bank "by Federal regulators, Continental charged off only 4.5% and classified only 15.1% of its Penn Square loans as nonperforming [while] Chase Manhattan Corp. had by then charged off 21.2% and classified 35.4% as nonperforming, and Seafirst Corp. had charged 4.4% and classified 27.3% as nonperformers."

78. "Troubled Nations Hold 11% of Foreign Loans by Continental Illinois," Wall Street Journal, November 29, 1982, p. 12.

79. Daniel Hertzberg, Tim Carrington, and John Andrew. "Confidence Game: Large Banks Are Hit By New Set of Rumors and Stock Prices Fall," Wall Street Journal, May 25, 1984, p. 1.

By the end of 1983 Manufacturers Hanover had $6.5 billion in loans to the four largest Latin borrowers which amounted to 284% of its shareholders equity. In addition, Hertzberg, Carrington, and Andrew report

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that there were rumors in the London money market that Manufacturers Hanover "was selling off a large position in British government bonds."

80. Ibid., p. 6.

Citicorp was first in line among U.S. banks in entering the Latin American loan market in the late 1960s. See "Citibanks's Pervasive Influence on International Lending," Business Week, May 16, 1983, p. 124. It also happened to have led U.S. banks into Latin America in the 1920s as well. See Sampson, op. cit., pp. 69-70.

81. "Citibank's Pervasive Influence," Ibid., p. 126.

82. "Corporate Profits Advanced 31% for Second Quarter; Rises Are Expected to Extend Into '85 At Slower Pace," Wall Street Journal, August 6, 1984, pp: 2, 12.

Banks registering earnings declines included Citicorp, Bank America, Chase Manhattan, Manufacturers Hanover, and J. P. Morgan--all with significant Latin American loan exposure.

83. Yves Maroni. "How to Borrow Reasonably," International Finance Discussion Paper No. 203, Federal Reserve Board of Governors, February 1982.

84. Hyman Minsky. "Financial Interrelations, the Balance of Payments, and the Dollar Crisis" in Jonathan D. Aronson (ed.). Debt and the Less Developed Countries. Boulder: Westview Press, 1979, pp. 103-22.

85. The financial instability hypothesis has been elaborated by Minsky in a variety of places. Of particular note are his essays "Can 'It' Happen Again" reprinted in Hyman Minsky. Can "It" Happen Again?: Essays on Instability and Finance. Armonk: M. E. Sharpe, 1982, pp. 3-13; "Longer Waves in Financial Relations: Financial Factors In the More Severe Depressions," American Economic Review: AEA Papers and Proceedings, Volume 54:3, May 1964, pp. 324-35; "The Financial Instability Hypothesis: A Restatement," Thames Papers in Political Economy, Autumn 1978 and his book John Maynard Keynes. New York: Columbia University Press, 1975.

86. Minsky, "The Financial Instability Hypothesis," op. cit., p. 15 indicates that enterprises can take up "three types of financial postures"--hedge finance, speculative finance, and Ponzi finance positions. In the first case the inflow of cash is expected to exceed the outflow of cash in every period, so that financial units in such a position expect to cover their immediate debt obligations with current gross receipts. Speculative finance units can be expected to run shortfalls in the near-term but "in the longer term are expected to [have cash inflows that] exceed cash payments commitments that are outstanding." In the short-term the speculative finance unit will have "to roll over or refinance debt . . . ." Finally, the Ponzi finance unit only can

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cover its debt obligations by reaping "a 'bonanza' in the future which makes the present value positive for low enough interest rates." In the meantime, it must continually raise "its outstanding debt to meet financial obligations."

87. In the late 1970s, Charles Kindleberger, Manias, Panics, and Crashes, op. cit., passim, adopted a Minsky interpretation of lending bursts leading to borrower default and a revulsion on the part of the lenders. He seems to have moved somewhat away from this interpretation lately.

88. See especially Hyman Minsky, "The Federal Reserve: Between A Rock and a Hard Place," Challenge, May/June 1980, pp. 30-6. In personal correspondence dated July 11, 1984 Minsky wrote the following to me: "No banker and businessman--not even Continental Illinois and its clients--entered upon contracts with the expectation that loans would not perform. But the individual decision makers--even at the scale of Citicorp--do not have command over system performance. Furthermore, the prevailing conventional wisdom is that the economy is capable of sustained expansion at stable prices and of course the Captains of Industry (and Finance) believe in the virtues of Capitalism and consider anyone pointing out the flaws of capitalism as such as being subversive or worst. Past crises and depressions are imputed to institutional weaknesses or policy errors--not any inherent characteristics of our economy. The 'alibis' for preceding performance shortfalls are believable: for example if you read Friedman and Schwartz's Great Contraction would you believe that the contraction reflected deep flaws in our economy or that it was due to avoidable policy errors by the Federal Reserve in managing The Money Supply?" (emphasis in original)

89. My colleague Bobbie Horn suggested this interpretation of the repetition of overlending in the Minsky model.

90. Minsky, "The Federal Reserve," op. cit., p. 35.

91. An instance when the Fed performed such a function was its effort to protect depositors at the London branch of Franklin National in 1974. See Minsky, Ibid., p. 32.

92. See Charles Lipson. "The IMF, Commercial Banks, and Third World Debts," in Jonathan David Aronson (ed.). Debt and the Less Developed Countries. Boulder: Westview Press, 1979, pp. 317-33.

93. Robert M. Solow. "On the Lender of Last Resort" in C. P. Kindleberger and Jean-Pierre Laffargue (eds.). Financial Crises: Theory, History, and Policy. Cambridge: Cambridge University Press, 1982, p. 238.

94. Stephen Knapp. "The Rescuer of Last Resort," Time, July 30, 1984, p. 88.

95. Ibid.

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96. G. Christian Hill, "Lender Beware," op. cit., p. 1 writes: "The FDIC expects less than 10% of these problem banks [the 650 banks on its problem-loan list in March 1984] to fail, and even if somewhat more than 10% collapse, its $15.5 billion insurance fund can absorb the cost." The FDIC has had to handle 54 bank failures by September 1984, the largest number since the Depression years. See Tim Carrington and Daniel Hertzberg. "Money At Risk: Financial Institutions Are Showing the Strain of a Decade of Turmoil," Wall Street Journal, September 5, 1984, p. 1.

97. For example, Richard Alm "World Debt Crisis Backlash," The Washington Times, June 27, 1984, p. 3 C reports:

> "IMF aid rarely comes without strings. In most cases, the IMF imposes rigid austerity, a formula that usually includes sharp cutbacks in budget deficits, an end to consumer subsidies, currency devaluations, and ceilings on wage rates.
>
> "'They all hit very hard at poor people,' says Richard Feinberg of the Overseas Development Council.
>
> "Poor people made poorer often take to the streets, and that's what frightens Latin America's political leaders. The Dominican Republic, a Caribbean island nation with a debt of $2.5 billion, erupted in riots that killed 60 people and injured 200 others in April after the government raised prices on basic foods to help qualify for renewal of a $450 million IMF loan."

Also see S. Karene Witcher. "As Latin Debtor Nations Prepare to Meet Political Unrest Becomes A Big Concern," Wall Street Journal, June 19, 1984, p. 33.

98. Rudolf Hilferding. Finance Capital: A Study of the Latest Phase of Capitalist Development. London: Routledge Kegan Paul, 1981. (originally published in German in 1910).

99. Sampson, op. cit., pp. 94-109.

100. Dennis Jacobe, research director of the U.S. League of Savings Institutions, has made just such a point while complaining about the inequity of the FDIC's rescue policies. See Hertzberg, Carrington, and Andrew, op. cit., p. 6.

101. Such a shift is described in G. Christian Hill and Edwin A. Finn. "Confidence Crisis: Big Depositors' Runs On Beleaguered Banks Speed the Failure Rate," The Wall Street Journal, August 23, 1984, pp. 1, 6. On p. 6 the authors report, for example, that "Jean Campbell, who runs a tax service in Sun Valley, California, took out $420,000 of uninsured deposits held at American Pacific by a client. She is placing most of the money at Bank of America, the nation's second-biggest bank, and Home Savings of America, the second largest thrift."

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102. Tim Carrington. "U. S. Agencies Want Nations's Banks to Disclose More Data on Problems," Wall Street Journal, August 22, 1984, p. 27.

103. See Willene A. Johnson. "Bank Size and U.S. Bank Lending to Latin America," FRBNY Quarterly Review, Vol. 8:3, Autumn 1983, pp. 20-1 and Willene A. Johnson. "U.S. Bank Lending to Latin America:. The Implications of Bank Size," Federal Reserve Bank of New York Research Paper No. 8320, January 1984, p. 33. Johnson suggests that the smaller banks can pull back more easily because they hold a larger proportion of short term claims on LDCs. Her work is the most detailed on differences in lending to Latin borrowers by banks of different sizes.

104. See Jane D'Arista, op. cit., p. 63.

105. See Johnson, op. cit.

106. A. W. Coats has told me that he considers the Baring Crisis in the 1890s to be an exception to this general principle.

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